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ISSUE

¶1. Summary. Each week, Embassy Pretoria publishes an economic newsletter based on South African press reports. Comments and analysis do not necessarily reflect the opinion of the U.S. Government. Topics of this week's newsletter are:

- Interest Rates Remain Unchanged;
- December's Trade Surplus Though Trade Deficit for Year;
- Money Supply and Credit Growth Higher than Expectations;
- Growing Fears of Transnet Strike Impacting Manufacturers;
- Manufacturing Sector Shows Weakness in January;
- Job Creation Perceived Essential;
- Unemployment Remains SA's Biggest Challenge;
- Continued Provincial Underspending Expected; and
- Half of Municipalities Fail to Submit Financial Statements.

End Summary.

Interest Rates Remain Unchanged
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¶2. The Monetary Policy Committee (MPC) of the South African Reserve Bank (SARB) announced that the repurchase rate would remain at its current 7% during its fifth consecutive meeting which resulted in no change in interest rates. SARB cited robust credit demand and high oil prices as the biggest risks to future inflation, although SARB saw little evidence of second-round inflation coming from higher energy prices. According to SARB's current forecast, CPIX (targeted inflation which excludes mortgage costs) should peak at 4.9% in the 1st quarter 2007, reaching 4.7% by the end of 2007. SARB also noted additional inflationary risks from higher food prices, although asserted that 2005 food prices were relatively low so food price acceleration in 2006 is not unexpected. The MPC decision was expected, as most financial analysts expect future movements in interest rates later in 2006 or early 2007. All 20 economists in the Reuters poll expected that the MPC would leave interest rates unchanged during the February meeting. Source: Statement of the Monetary Policy Committee, and Reuters, February 2.

December Trade Surplus Though Trade Deficit for Year
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¶3. December's trade surplus of R3.9 billion, the first trade surplus in six months and the largest in two years, increased over November's deficit of R3.1 billion due to reductions in imports of machinery and electrical

equipment, according to the South African Revenue Service. Exports reached R29.6 billion, a reduction of R833 million from November's level, while imports declined by significantly greater amount of R7.8 billion, reaching R25.7 billion. Despite the monthly surplus, the trade account showed a deficit R21.8 billion for 2005, almost double the 2004 R12.7 billion trade deficit. December's value of exports and imports declined 2.7% and 23.3%, while the 2005 value of exports and imports increased 12.1% and 14.6%, respectively. Many argue that the holidays explained the increased December trade surplus. Retailers increased purchases in preparation for the holidays, as imports showed gains in October and November and subsided in December. According to Kagiso Securities economist Elize Kruger, a continued trend of current account deficits underscore the need for capital flows to finance deficits and represents the biggest risk to a stable outlook for the rand. Source: Standard Bank, Foreign Trade Alert, January 31; Business Day, February 1.

Money Supply and Credit Growth Higher than Expectations
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¶4. Demand for credit by the private sector rose by 19.7% in the year to December, above market expectations of 18.6%, and faster than November's 18.8%, according to the South African Reserve Bank (SARB). The broadly defined M3 measure of money supply grew by 18.1%, above consensus forecasts and November's growth of 17.3% and 16.4%, respectively. The SARB also indicated that its international liquidity position rose to $17.2 billion in December from $16.5 billion in November, increasing its import cover ratio to 20.3 weeks (or 5.1 months) compared to November's import cover of 15.4 weeks. Source:



Business Day and I-Net Bridge, January 31.

Growing Fears of Transnet Strike Impacting Manufacturers
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¶5. Manufacturers are beginning to fear that the Transnet strike, which began on January 30, will lead to possible shortages in raw materials and delays of their shipping schedules. Four striking labor unions (South African Transport and Allied Workers Union, United Transport Alliance Union, United Association of South Africa and South African Railways and Harbors Union, involving 15,200 workers) disagreed with Transnet's process of disposing its non-core business units without obtaining prior union approval. The strike started in Richards Bay and Durban, and if not settled, will impact Port Elizabeth and Cape Town and will then become nationwide. According to Reuters, the strike could cost R100 million ($16.7 million) a day. As the strike continues, the impact on the Durban container terminal, handling 65% of South Africa's container traffic, will become more pronounced as exporters may not meet shipping schedules but are still liable for the fee. The unions claimed support for the strike was close to 100% of workers at key Transnet operations of ports, freight and commuter rail in the KwaZulu-Natal province. According to Transnet, 4,000 workers had participated in the strike, while the unions said 9,500 workers were involved. Pradeep Maharaj, Transnet's Executive for Strategy and Transformation, said the Durban container terminal was operating at 40% capacity on January 31, down from about 65% the previous day. Source: Business Day, January 31; Business Report, February 1.

Manufacturing Sector Shows Weakness in January
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¶6. In January, manufacturing activity declined sharply showing possible contraction in the near future. The Investec Purchasing Managers Index (PMI), a leading

indicator of South African manufacturing activity, fell to 48.1 from 52.5 in December. January's activity index reached below 50, indicating a contraction in manufacturing activity, for the first time since October ¶2003. The recent strength of the rand explains January's weakness, although slower manufacturing growth prospects should not impact overall South African growth, according to ABSA economist Monale Ratsoma. Consumer spending and infrastructure spending remains the main drivers for 2006 growth, and over the longer term, manufacturers will adjust to a strong rand by increased efficiency. The largest declines in the PMI came from the subindices for business activity and new sales orders, which together account for about 45% of the overall index. The business activity index dropped to 49.2 from 55.5, while new sales orders also fell, to 47.9 from 53.1. The sector employs 1.2 million people and accounts for more than 16 percent of gross domestic product. Source: Business Day and Business Report, February 2.

Job Creation Perceived Essential
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¶7. In February and July 2005, marketing firm Research Surveys conducted metropolitan surveys showing that South Africans thought job creation was very important and the government had not done a good job in its job creation policies. Only 29% of the people interviewed in February agreed that the government had done a good job reducing unemployment, while 64% disagreed and 7% did not know. By July, 13% thought the government was creating jobs fast enough, 81% said jobs were not being created fast enough, and 6% did not know. The survey sample was 2,000 South African adults in seven metropolitan areas. Source: Cape Times, January 30.

Unemployment Remains SA's Biggest Challenge
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¶8. According to "Projection of Future Economic and Sociopolitical Trends in SA up to 2025," released by the Bureau for Market Research (BMR) at the University of South Africa, unemployment remains South Africa's biggest challenge, followed by crime, economic growth, skills and



HIV/AIDS. More than 45% of those surveyed said they expected only a slight decrease in unemployment by 2007. Another 25% expected the unemployment level to stay the same. A panel of 13 economists polled did not expect employment growth to exceed 1.6% between 2005 and 2010 because of labor market legislative rigidities, a limited pool of sufficiently skilled workers, and a skewed skills mix available for employment. The panel of economists expected that South African growth would reach 3.3% between 2005 and 2010, with average growth rising to 3.6% between 2011 and 2025. If rigidities in the economy and skill deficiencies were eliminated, growth above 5% was possible. Reduced corruption seemed unlikely, for both corporations and government. More than 85% of all participants expected corruption in government to either stay the same or get worse by 2007, and only 14% of the panelists saw a decrease in corruption by 2010. Close to 90% expected corporate corruption to either stay the same or get worse by 2007. The BMR study surveyed 72 South African chief executive officers and economists. Source: Business Day and Business Report, January 31.

Continued Provincial Underspending Expected
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¶9. The National Treasury expects continued provincial underspending on capital projects during the current fiscal year (ending March 31). The National Treasury's figures on provincial expenditure showed provinces spent 71% (R155 billion, $26 billion using 6 rands per dollar)

of their total adjusted budget of R219.2 billion ($37 billion) by end-December 2005, but only 55% (R7.7 billion, $1.3 billion) of their R13.3 billion ($2.2 billion) capital budget. The capital expenditure was higher than the amount spent over the corresponding period in 2004; however, Treasury expected that provinces would underspend by the same proportion as in the 2004/05 financial year. Lack of skilled staff hampers local and provincial authorities spending, accounting for the poor provision of services in many rural parts of the country. Significantly low rates of capital spending were concentrated in Limpopo (42.7%) and Free State (45.9%) with the highest being Eastern Cape with 65.6% and Mpumalanga at 63.7%. Total provincial spending ranged from the lowest share of 68.3% in Free State and 68.4% in North West to the highest at 72.2% in Eastern Cape and 71.8% in Mpumalanga and Northern Cape. Source: Business Day, January 31.

Half of Municipalities Fail to Submit Financial Statements
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¶10. Nearly half of South Africa's 284 municipalities did not submit annual financial statements, according to Auditor General Shauket Fakie. The Municipal Finance Management Act requires that all accounting officers must prepare annual financial statements within two months of the financial year end. The current financial year was the first in which the Municipal Finance Management Act of 2003 was implemented and 148 or 52% of all municipalities met the submission date of August 31, 2005. A total of 35 (12%) submitted statements between September 1 and 30 2005 while a further 101 (36%) had not submitted annual financial statements by the end of September. The 2005 compliance levels, however, were an improvement over 2004. At the end of August 2004, only 6% of municipalities had submitted statements for the 2003/04 year while a further 29% had submitted by the end of September. Altogether, 65% had not submitted annual financial statements by September ¶2004. Source: I-Net Bridge, February 2.

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